Northern Illinois University

The Savings And Loan Crisis

A Thesis submitted to the University Honors Program

In Partial Fulfillment of the Requirements of the Baccalaureate Degree

With Upper Division Honors

Department of Finance

By

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Graduation: May 1989

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Department of: Finance

Date: 4-19-1989

JOURNAL OF THESIS ABSTRACTS

THESIS SUBMISSION FORM

AUTHOR: Robert S. Sturgis IV

THESIS TITLE: The Savings And Loan Crisis

THESIS ADVISOR: Dr. William Wilbur

ADVISOR'S DEPT: Finance

DATE: April 5, 1989

HONORS PROGRAM: University Honors Program

NAME OF COLLEGE: Northern Illinois University

PAGE LENGTH: 62

BIBLIOGRAPHY (YES OR NO): Yes

ILLUSTRATED (TES OR NO): Yes

COPIES AVAILABLE (HARD COPY, MICROFILM, DISKETTE): Hard Copy

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SUBJECT HEADINGS; Thrift Crisis, Results of S & L Deregulation, The Texas Disaster, How To Resolve The Thrift Crisis

ABSTRACT (100-200 words):

The Savings and Loan Industry is fighting for its life as one-third of the industry seems to be having serious financial difficulty. The final cleanup cost for the taxpayers has been estimated by independent analysts to be at least $100 billion. It was the lack of funds that caused the Federal Savings and Loan Insurance Corporation to keep the doors of insolvent thrifts open. It was this that seems to be the main reason for the high cost, because by keeping these sick thrifts open and by letting them do the same kind of business that caused them to be in that

shape, they only put themselves deeper in the red. My sources for the project came from approximately 60 articles from various periodicals. I became very acquainted with the problem and was able to write the paper from what I had learned. My conclusion is that Congress is to take most of the blame because of their deregulation bills allowing thrifts to get out of their traditional role of providing home mortgages and putting them in direct competition with banks. Also Congress's poor funding of FSLIC has allowed them to lose control of the industry.

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Introduction

This paper concerns the latest crisis in America. It is a crisis that by the latest estimate may cost the taxpayers over $100 billion. This is the evergrowing thrift crisis. Everyone seems to be concerned about the problem, but little is being done to resolve it. The government agencies' estimates for a total bailout are ridiculously low and it seems that no one wants to confront this problem. President Bush, when first elected, came out strongly in favor of funds for the Federal Savings and Loan Insurance Corperation so that insolvent thrifts might be disposed of. Mr. Bush proposed a $50 billion sale for the industry, but since that time no action has been taken. Are issues only considered when they are in the media spotlight? One thing for certain is that the President must quickly handle this problem before it balloons into a situation that is uncontrollable and before all hopes of balancing the budget are gone.

In this paper I will begin by expressing the magnitude of the problem along with key factors that may have contributed to it. Also, bank failures and their history will be discussed. After that I will examine the Texas crisis, where half of the insolvencies are located, along with most of the fraud associated with it. The mid-section will include Congress's role in all of this, will take a look at the S & L industry to see if it still has a purpose, and will point out what action the deposit insurance agency,

FSLIC, is taking to solve the crisis. The following sections will look at some tough decisions Congress will have to make regarding who should pay for the cleanup of the industry. During the conclusion, I will present certain recommendations that I feel may be appropriate as a solution to our current crisis and ways to prevent it from ever recurring again.

After reading this paper, I hope that you will have a clear understanding of the situation involving the thrift crisis as well as realize possible solutions to this current problem.

I. The Scope Of The Problem And How It Happened.

Anyone keeping abreast of current issues knows that we have an impending disaster on our hands, but no one seems to realize its scope. There are constantly conflicting reports between the Federal Home Loan Bank Board (FHLBB), the General Accounting Office (GAO) and independent researchers concerning how much the bailout of the thrift and bank industry may cost the taxpayers. Notice I stated what the bailout "may cost the taxpayers". To this day, not one dollar from the taxpayers of America has been used in this crisis, but that situation will probably change. Congress's banking committee is currently hearing opinions from various sources as to the extent of the problem and how it should be resolved using taxpayer monies.

In order to try to give you an idea of the extent of the crisis, let me summarize the history of the banking and thrift industry during the last few years.

Despite six years of economic expansion and prosperity in the United States, many thrifts and banks have had nothing but problems. During 1987 50 banks failed and more than 140 S & Ls were declared "troubled" or insolvent. Then in 1988 the numbers ballooned to now include 200 bank failures and approximately 500 S & L insolvencies. Also, there are almost 1500 banks in trouble, according to the FDIC, out of the nationwide total of 13,700 banks. Some

people may not have expected 1500 banks to be in financial trouble since the first half of 1988 produced record earnings of $10.5 billion. This contrasted with the $10.6 billion loss that banks recorded in the second quarter of 1987, because of the increased allowances in their loan loss provision accounts charged for expected losses in Latin American debt. Also on the bright side for banks was FDIC's statement reporting increases in bank capital, return on equity, and asset quality, while bad assets and problem banks decreased all in the first half. While FDIC chairman William Seidman positively stated that "For the first time in a long time all of them (indicators) are going in the right direction", other FDIC officials pointed out that Southwest banks continued to suffer from severely depressed real estate markets. The latter statement was made in response to losses by Texas banks in the first half of 1988 of $2.9 billion - $2.3 billion being tied to First Republic Bank Corporation.

Unfortunately for Savings and Loans the outlook is not as bright. Over 450 S & Ls have closed in the 1980s and literally hundreds more are on the verge of collapse. Of the Nation's 3200 thrifts, 503 are declared insolvent, and another 629 have less capital on their books than is required by FHLBB regulators. To point out the pitiful condition of S & Ls, in 1987 unprofitable thrifts lost $13.4 billion burying the profitable ones which earned only $6.6

billion. Finding the weakest region for thrifts is not very difficult, when you consider that more than half of the loss from unprofitable thrifts came from Texas based S & Ls. Texas, with its 281 unprofitable thrifts, lost $6.9 billion last year. Then when you consider the figures for the rest of the country, and see a combined profit of only $100 million, it is obvious that the entire industry is very unstable. Also, close to 35% of the industry keeps falling further in debt with no end in sight. The Federal Savings and Loan Insurance Corporation (FSLIC) has already placed $25 billion of its own money into some of these failed thrifts. Much of the money is in promisary notes and guarantees not officially guaranteed by the government yet. Some good news has recently surfaced showing third quarter earnings have reduced losses to $1.5 billion from $3.8 billion in the second quarter. This is due to increasing mergers and acquisitions of insolvent thrifts. Also, it is important to point out that of the $3.8 billion loss in the second quarter, $3.7 billion was linked to 50 thrifts alone.

Now let me explain how the thrifts positioned themselves into this messy situation. The industry's problems trace back to the early 1980s when the simplicity of taking deposits and writing home mortgages was transformed into a potential nightmare. As inflation jacked up interest rates above the rates they charged for loans, the thrifts found themselves paying out more money than what

they were taking in. New entrants into the financial services industry were stealing deposits away from the helpless thrifts. This was due to Regulation Q forbidding them to pay more than 5.5% on deposits. Hopelessly burdened with their low fixed-rate, long-term mortgages, many thrifts sat idly as their capital dwindled. It did not take long for the "big guns" in the industry to lobby for what seemed in the early 80s to be necessary changes. It was clear that S & Ls had to expand out of their role as home financiers, which dwindled from 46% of total mortgages in 1970 to a present 28%.

It took little time for Congress to buckle under to the rich and influencial owners of S & Ls. Congress soon gave these owners expanded powers into everything from checking accounts to commercial loans. This, of course, let them venture out of their low profit mortgages and into direct competition with banks. Also, Congress phased out interest rate caps under Regulation Q and went as far as to allow thrifts to pay 1/4 of 1% more on deposits than banks, thus stealing away some of the banks' deposits.[1] Later in this paper I will discuss in more detail the role Congress played in the present crisis.

Many of today's thrifts barely resemble the home mortgages that were available ten years ago. Instead, the thrifts look more and more like full-blown financial institutions offering a variety of services. Thrifts seem

to have forgotten the traditional role of their industry, as it slips into the hands of commercial banks and mortgage bankers, who originate and then quickly sell the home mortgages in the very active secondary market.

The condition of the Texas thrifts may have started when oil prices jumped, reaping in money for many oil companies. Thinking that oil prices would stay relatively high, if not higher, many of these companies expanded, looking for more oil, courtesy of the local S & L. Commercial real estate came into play in 1981 when Congress passed generous tax write-offs adding fuel to the fire. This touched off a frenzy of speculative real estate that ended in a glut of office towers, shopping centers, and condominiums. So when developers were not able to make their payments to the thrifts due to lack of rentees or buyers, the thrifts repossessed the property offered as collateral. Of course, when the S & L tried to acquire their money back by selling the property, they were faced with taking a huge loss. Many decided to hold on to the property hoping the depressed conditions will reverse and thus enabling the S & L to recover their loan, but while they wait they are still paying the depositor for the money used for that property.

Then an awful plague began. Some developers who were turned down for commercial real estate loans by successive thrifts, figured that they could lay a few million dollars

down for capital, and then open a thrift and have Uncle Sam guarantee all of their deposits, which they could then haphazardly throw into their wild ventures. For real estate developers opening their own S & L, it soon became the "in" thing to do. Millions of dollars soon became available to these foolhardy investors, at the government's and eventually the taxpayers' expense.

These new owners soon invested all of their deposits, mostly into their hair-brained schemes. At one Texas thrift 96% of their loans were delinquent![2] After the deposits ran out and the doors were still opened to new investments, they began searching for new sources of funds. These funds were soon found in the repo-repurchase agreements market. A repo allows a bank to leverage itself by finding an investorto give a bank cash in exchange for selling mortgages, in which the thrift agreed to buy back at a predetermined price in a predetermined number of days. With the repos being easily renewed at the will of the thrifts, these in a sense became deposits to them. Soon S & Ls flourished as repo money came pouring in to be invested in the rapid growth of real estate. An example of "repo abuse" was the Financial Corporation of America owing $14 billion to leading investment bankers, coming close to the $17 billion in deposits.[3] For others, repos were not good enough. American Diversified was not exactly your traditional thrift. It was basically a "basement thrift" with no

branches, no tellers, and no ATM's. Their employees consisted of salesmen working the phones all day attempting to land big deposits from brokers - brokered deposits, large corporations, and wealthy people.

As you can expect, these deposits did not come cheaply. This past June, when Certificates of Deposits averaged 7.07%, American Diversified advertised a 8.64% rate.[4] Another astounding statistic was their average account being $90,000![5] I believe it was described best by David Zigas, "All a cash-starved thrift needed to do was advertise some sexy rates, set up an 800 number, and wait for the checks to roll in." Another good example of thrift abuse was the shady dealings by Ed Mc Birney who helped to turn the now government-operated Sunbelt Savings from a $5 million to a $1.5 billion asset institution offering risky "no money down" commercial real estate loans. Loans in one Texas thrift have skyrocketed 1000% up to $1.3 billion.[6] An example of the abandonment of the traditional role for S & Ls was a founder of Sunbelt Savings stating that Sunbelt "has not given anyone a home loan for months.

With their freshly deposited cash, many thrifts invested into markets that they had no knowledge or experience in. Examples are banks operating hamburger and barbeque beef franchises. One bank even invested in a thoroughbred breeding stallion, which later ended up having syphilis.[7] One outrageous scheme involved a commodities

salesman getting Territory S & L into a complex interest-rate hedging strategy. Instead of protecting Territory's $18 million assets, it cost the S & L $10 million within six months. The first time that Wichita Federal played in financial futures it came out with $26.5 million in three years. Unfortunately, when they went back again, they lost $17.5 million in two months.

From 1982 until 1986 Texas thrifts were expanding, much beyond the capability of the economy. They should have cut back. As a result, their assets jumped from $36 trillion down to $100 billion.

During 1985 the Federal Home Loan Bank Board, under the direction of Edwin Gray at the time, finally realizedthe impending disaster. Gray then asked for more regulators at an increased pay. This was in order to make them competitive with similar private jobs and to retain them. The Reagan Administration's policy of deregulation caused the Office of Personnel Management to reject the idea, even though the taxpayers would not have paid for it.

By 1986 when the thrift failures began their snowballing effect, the FSLIC ran out of money and actually became insolvent itself. The FSLIC then had to ask the U.S. Treasury for help. The Treasury and a few legislators actually favored an enormous injection of capital, but when the S & L owners heard about the FSLIC's need, they immediately jumped to the conclusion that the money would be

used to liquidate many of their thrifts. Assuming this, the owners pressured their friends in Congress to issue far less than was necessary in bonds to the FSLIC.

The point that I would like to make now is that the crisis could all have been prevented with adequate regulation, which was not around when the S & Ls made the investments mentioned in the previous paragraph. What actually seemed to be happening was that regulators were covering up for insolvent thrifts.[8] The thrifts also used their friends in Congress to preserve an illusion of insolvency. An example was the Garn-St. Germain Act in 1982 that allowed accounting gimmicks such as their low and even negative capital behind notes issued by the FSLIC to S & Ls whose capital was under 3% and had two consecutive losing quarters. This seems to include about half of the industry as the national average of thrift capital currently stands at 2.8% of assets. Quick-buck artists illegally hide losses from regulators by swapping bad loans with each other when they are about to be inspected, to give a false sense of security in the thrift.

Since the problem has become a crisis in the public's eye, the Bank Board has taken action including doubling their number of field force examiners, along with giving substantial pay increases, higher net worth standards, a barrier on growth and direct equity investment, and better reporting requirement. The question is, have these actions

arrived in time? Probably not, since the damage has been done. All that these changes can do now is to protect against future problems.

In summing up this first section, we must realize that we face a real possibility of a breakdown in our financial markets, due to the increasing rate of insolvencies.

Although half of the insolvencies are coming from Texas due to their relaxed banking laws, the banks in agricultural areas are facing similar problems. Their problems are parallel to Texas, but instead of being dominated by commercial real estate loans, these farming thrifts are hooked to their agricultural loans, and are unable to expand geographically.

As you could tell, there are a large number of people to blame for our current crisis. Could it be Congress? Or maybe the rich and powerful S & L owners? How about the FSLIC? By the time you finish reading this paper, you will have a better understanding of who is at fault.

II. Bank And Thrift Failures: Should We Be Worried?

When bank failures come into mind, the first thing that we associate with them is the Great Depression. Bank failures most likely played a part in the Depression. Within two years, 1932 and 1933, 40% of the Nation's banks failed and the money supply dramatically contracted. This contraction was due to the leftover banks not being able to loan much money out because of the limited amount of funds available. With the depositors pulling their funds out of the banks, much of what the banks were left with were long time loans, in which there was not a secondary market to sell these loans in like there is today. Bank failures back then had a so called "domino effect" because when a few banks went under it would cause a panic bringing down other banks due to their low liquidity. Also, nearby banks may have lent the failed bank money which would then be unrecoverable without deposit insurance. Nowadays deposit insurance reduces the "domino effect" since depositors are guaranteed to get their money back. Depositors are still hesitant to keep their money in a troubled bank. When a bank is liquidated the depositor must fill out forms declaring what they have in the bank. It may take several weeks to receive their money, during which time they make no interest on their deposits.[9]

When depositors take their money out of what they perceive to be an unsafe bank, they do one of three things with the money. Where they put their money is important, for it could adversely affect the economy if done in numbers.

The first option, which persons with newly withdrawn money may do, is to redeposit it at what in their opinion is a safer bank. This choice causes little disruption and only affects the old bank, while the Nation's money supply remains the same.

The next choice that may be selected is removing the money from the banking system. This happens at times such as now, when there are many failures and depositors with over $100,000 feel that it is too risky keeping it in an unstable industry. Instead, the prime option tends to be the safest of them all - Government securities. The common choice is also the most liquid - the three month Treasury Bill. This choice will partly contract the money supply as banks must sell a liquid asset to cover for the withdrawal or call in a Federal Funds transaction, forcing other banks to do likewise. It will then expand the money supply, as the government spends what money it receives, though not as much as it is contracted.

The last possibility is holding currency outside the financial system. This is not very likely to happen, since most people are rather efficient with their money. People

are efficient by always looking for the highest rate at the minimul risk. By holding money you lose the value of it due to inflation, not to mention the lost return above inflation. Overall, most depositors have faith in the government to back their deposits, so holding currency is useless, unless for small ticket items.

To summarize this section, I would like to stress that the so called "domino effect" that happened during the Depression really has no chance of recurring as long as deposit insurance is available. Also, I discussed the various options of people who withdraw their money from a bank. If the withdrawal is placed in another bank, or is used to purchase safe securities, the money is then injected back into the money supply. As I explained before, holding currency is not likely, due to devaluing forces such as inflation. So basically we should not worry concerning a run on the banks or a sharp decrease in the money supply choking off potential borrowers and shrinking the economy. We should worry about the condition of many institutions, particularly in the Southwest, who all appear to be in a messy situation. The unfortunate problem is that the taxpayers will have to pay for the mess that the thrifts are in. That is the main concern.

III. The History Of Bank Failures.

With help from my sources, I have divided the history of banks into four main groups, beginning with the Civil War and ending with the Present.

The first section, 1865 - 1919, experienced the real growth in numbers of banks. From only a few thousand banks in 1865, this number skyrocketed up to 30,000 by 1920. Amazingly with all of this competition in a much smaller market than today's, banks survived with few problems, although in some years there were over 100 banks that failed, and in 1893 over 200 banks closed their doors. When considering the great numbers of banks, the linited amount of money available, and the lack of deposit insurance, those numbers are quite respectable. Nowadays, with deposit insurance, a vast amount of money available, and fewer banks and thrifts, it is hard to believe that some of our institutions are drastically failing.

The next part, 1920 - 1928, was characterized by large numbers of bank failures. With failures climbing over 600 per year, and with a failure rate twice that of normal businesses, it is difficult to believe that the economy was not shaken. The only explanation I can offer for the high failure rate is to assume that competition must have been taking its toll during this period. During this time the number of banks was at an all time high. With more banks

chasing the same amount of dollars, it should have been obvious that some banks would fail due to the competition with other institutions.

From 1929 - 1933, the Nation saw a dramatic swing for the worse in the banking industry. At this time the country was going through its worse time in history - the Great Depression - with banks being a negative factor economically. Because many people could not repay their loans during this period, the banks were unable to repay their depositors. This resulted in depositors scrambling to withdraw funds from the troubled banks, guaranteeing failure for them. It soon became evident that the entire industry was in trouble. Many depositors played it safe by pulling their money out of their bank, regardless of its financial condition. The number of withdrawals took its toll economically by decreasing the money supply and hampering the bank's loaning ability, which the business community so badly needed to get back on its feet again during these troubled times.

During these 5 years the number of banks was dramatically falling, with nearly 10,000 banks closing their doors. There was a severe financial crisis in the United States, that the newly elected President, Franklin D. Roosevelt, had to take care of quickly for the sake of the economy.

During the period 1934 - 1981, bank failures were virtually nonexistant. This was due to Congress establishing the Federal Deposit Insurance Corporation on January 1, 1934. With the FDIC covering all deposits up to a certain amount, deposits came pouring back into the system. It was obvious at this time that the FDIC helped to get the economy back on track and also kept it stable.

IV. The Savings And Loan Problem In Texas.

Texas, the home of nearly half of the Savings And Loan Industry's problem banks, has many people to blame for its current condition. In this section I will look at several groups of people to determine each of their roles in contributing to the messy situation in Texas.

We already know that Congress contributed to the industry's problems by the passing of the 1982 Garn - St. Germain Act much to the delight at that time of the S & L owners. Thrifts in Texas already had experienced explosive growth at that time, and owners were positive that this would result in more profits as oil prices and real estate development continued to increase. Generous write-off for real estate passed into law in 1981 and fueled the frenzy. More risky real estate ventures became attractive due to these new tax breaks.[10]

This was only the beginning of the craze. The Texas State Legislature, in which many of the Representatives were undoubtedly taking contributions from the wealthy S & L owners, passed even more liberal laws than those Garn - St. Germain had passed. This included allowing S & Ls to invest 100% of their assets in speculative real estate ventures. One great example of the misuse of funds this law caused, was the thrift that loaned out almost all of its assets and then discovered that 96% of these loans were delinquent.

This example was most likely due to a culmination of events including the use of 100% of assets for loans and the write-offs given by Congress. Also in 1983 and 1984 Texas widened state charters to allow S & Ls even more involvement in real estate development.

Next to be blamed might be the Reagan Administration. Its Laissez-Faire politics meant that regulators and examiners were underfunded. With the Texas state examiners numbering only 19, they were obviously overloaded with work. Their starting salary, at $13,000, did not exactly attract quality personnel.[11] When Federal Home Loan Bank Board Chairman Edwin Gray realized these problems, and the fact that the S & Ls had not been examined for two years, he asked the Administration for help. The Office of Management and Budget replied, "Deregulation meant getting the government out of the industry."[12] Gray, realizing the eminent disaster of too few regulators in a speculative environment was able to make headway by forcing reappraisals based on depressed current market values, instead of estimated project values at completion. This meant drastically reduced collateral of billions of dollars for loans were chopped by as much as 30%. Of course, this set up a wave of fire-sales and foreclosures. The Dallas Home Loan Bank forced problem thrifts to foreclosure on delinquent loans. This move represented a "domino effect" as it forced developers to declare their projects insolvent.

The S & Ls declared them nonperforming loans, in which the FHLBB then declared the S & L insolvent. This vicious cycle resulted in scores of S & Ls joining the insolvency list of their industry. With mounting foreclosures on the horizon, the Dallas Home Loan Bank Chairman Ror Green, the governing chief supervisory agent in the region, recruited Joe Selby, the former acting controller of the currency, to lead the statewide audit. Gray brought in 270 examiners from other parts of the country for a blitz on the dishonest and potentially insolvent Texas thrifts. Gray was also given the necessary power to close any thrift in the state. This power was used repeatedly as Selby, a tough enforcer, declared S & L after S & L insolvent. Though the insolvencies were far overdue, it became evident that FSLIC, the insurer for the Nation's thrifts, was itself insolvent!

When I started this section I explained that I would mention several groups of people who were involved in this mess. But it seems as if one person alone may have had his own part in the current crisis resulting in possibly billions of dollars extra to be added onto the taxpayers' tab. This one man is Speaker Jim Wright of Texas. Speaker Wright obviously misused his power and influence to prevent the FHLBB from closing or harrassing S & L owners who had ties to him. Mr. Gray believes that Wright held up a bill in order to recapitalize the insolvent FSLIC and applied political pressure on FHLBB in order to delay regulatory

action against many Texas S & Ls. This delay resulted in hopelessly insolvent thrifts to remain open, and increasing the bailout by as much as a billion dollars or more. Speaker Wright responds to these charges by saying that he was only doing his job, representing the people who elected him. After reading several articles, it became clear to me that Wright definitely stepped outside of his ethical boundaries in forcing Gray and possibly others to help his contributors, not his constituents.

The following are some examples of wrong doing. In September of 1986 Speaker Wright called Mr. Gray on behalf of Craig Hall, a Texas land developer. Mr. Wright made it clear in the press that unless the FSLIC eased up on Texas S & L owners, he will stall the vote on a badly needed FSLIC Recapitalization Bill. Due to this pressure, Gray removed the FSLIC-appointed conservator foreclosing on loans made to Mr. Hall, and placed a conservator in who worked out a deal to keep Mr. Hall afloat. Days after helping Mr. Hall, Wright called Gray again, this time on behalf of Thomas Gaubert, owner of Independent American Savings. Besides being an S & L owner, Gaubert was also the finance chairman of the Democratic Congressional Campaign Committee which raised $9 million for the party. Mr. Wright told Mr. Gray that owners were complaining that the FSLIC was a "Gestapo" and was unfairly harrassing them. Mr. Gray took action by appointing an independent council to look into the

complaints. They eventually found the complaints groundless. Soon after this, Mr. Gauber's thrift, Independent American Savings, was taken over by FSLIC. By this time FSLIC grabbed Independent from Grauber. It had a negative net worth of $314 million. Gray stated that if Wright had not interfered, Independent would have been gone more quickly and obviously at a lesser cost. Speaker Wright was not finished quite yet. In December, 1986 Gray received another phone call from Wright, this time in regards to Vernon Savings. The speaker wanted imminent action on Vernon delayed, to which Mr. Gray obeyed, while still waiting for FSLIC's Recapitalization Bill to be passed. Although Speaker Wright stopped asking for Gray's help, it was 9 months after the last phone call before a less than adequate bailout bill was finally passed.

It should be noted that because of these actions taken by Mr. Wright to intervene on behalf of these insolvent thrifts, Wright is currently being investigated by the House Ethics Committee. Mr. Wright is also coming under fire for contributions of $240,000 from thrifts and real estate interests.[13]

Even though the previously mentioned groups accounted for some of our problems today, there is only one group that is honestly to be blamed. It is the owners of these insolvent or troubled S & Ls that must ultimately be responsible for their current situation. While many are out

of business, or are standing trial for their crimes, there are still some left in charge. It is up to the FSLIC to make sure that these dishonest owners are found and are quickly taken out of command, if we are to resolve this issue.

The trouble begins with the easy process an unscrupulous real estate developer can go through to acquire a Savings and Loan Charter. To show the extent of charters being issued, Texas currently has one S & L for approximately every 9,200 people.[14] Assuming that oil prices were to soon hit the roof, many developers started an S & L mainly to finance their own speculative real estate ventures, betting on the booming economic conditions that would result from high oil prices. Unfortunately for the taxpayers, these people were betting with our money. No matter what happened, they felt that they stood to lose nothing. If the projects were a flop, they figured they could walk away and Uncle Sam would have to pick up the pieces. As many developers found out, they did stand to lose something - their freedom. Many found their way to prison to anywhere from a few months all the way up to 25 years. These new S & L owners never realized the criminal implications of what they were doing, and they learned the hard way. But the financial problems that many of them left behind will be felt by tens of millions of people for possibly several decades.

So now the FHLBB and the federal governmewnt are left with a huge financial disaster in the wake of attempting to keep Gramm-Rudman targets. What the FHLBB has attempted to implement is their "Southwest Plan" to take care of insolvent thrifts in the Texas area. Danny Wall, FHLBB Chairman, hopes to consolidate 109 ailing Texas thrifts by May, 1989. There are two ideas that the Southwestern Plan may accomplish and will thus end up saving the industry billions of dollars. One is to eliminate some of the competition in the state through mergers of troubled thrifts into healthier ones. This would eliminate about 400 branches and thus reduce costs by approximately $500 million. Two, it may be able to lower the high premium S & Ls already pay compared to other substitutes by restoring confidence in the S & L industry.

To sum up this section, we can say that the Texas economy most likely began to expand after the second oil embargo in 1979 and continued into the early eighties. It was on this tremendous optimism about increasingly high oil prices that drove developers to build and expand rapidly. It was also the thrifts that fueled this expansion with easy credit, and the Congress by generous tax write-offs. So what happened? Oil prices ended up sinking down to $10 instead of up to $100 per barrel like many predicted. Of course, this set off an economic collapse in Texas, that

resulted in a glut of office towers, condominiums, and shopping centers. Because of this glut, the owners of these buildings face an extremely high vacancy rate. This translates into there not being enough income to support the owner's mortgage payments, and eventually many of these owners will have their property taken away by their mortgagee. This mortgagee very often tends to be an S & L which finds itself with an unmarketable building. Here is the problem that thrifts face. Do they sell the building for approximately 40-50% of its cost or do they hold on in anticipation of an upswing in the market?

So as the FHLBB try to merge the failing thrifts with healthier ones, we hopefully will see the industry rebound in Texas due to the lesser competition, and fewer crooked owners as regulation grows more important to maintaining a stable environment.

V. What Was The Role Of Congress?

One of the most important points to keep in mind throughout this paper is that the Savings And Loan Industry was originally created to help provide Americans with the dream of owning their own home. Unfortunately, Congress seemed to forget this role when they unwisely deregulated this industry to the point that the original mission of S & Ls is now hopelessly lost. Once in the hands of friendly neighborhood officers, many of these hands have been taken over by greedy and corrupt businessmen and real estate developers.

In the early eighties, thrifts witnessed the soaring of their cost of funds due to massive inflation present in the economy. So as cost of funds ballooned, their assets, comprised mostly of fixed-rate mortgages, remained the same. Since there was a cap on the interest rates S & Ls could pay, when interest rates in the money market surpassed the limit that thrifts could pay, there was a huge outflow of funds to higher rate money market and mutual funds.

To stop the erosion of a bank's funds, Congress passed two deregulation bills that inadvertantly steered the S & L industry on a course of reckless growth. The first bill happened in 1980. It called for a gradual removal of Regulation Q, and thus allowed thrifts to set interest rates according to the market. The 1980 bill also raised FSLIC insurance coverage, and consequently its risk, up to $100,000. The net result of this first deregulation act was

the fact that now any S & L could raise endless amounts of capital by manipulating their interest rates.

The second deregulation bill was the one that really sunk the thrift industry's boat. The Garn-St. Germain Act of 1982 allowed accounting gimmicks that hid the alarming deterioration of a thrift's financial position. Savings and Loans would defer losses and hide the inadequacy of their capital with notes from the FSLIC. These FSLIC notes could be used as equity so that when regulators or investors looked at their balance sheet on computed capital to asset ratios, it appeared that the thrift was afloat. These notes kept the doors open of hundreds of thrifts managed by crooked operators. This extra time allowed them to make even more haphazard loans, and this put the industry into an even deeper hole. The bill also allowed S & Ls to branch out into nontraditional activities, such as real estate and business laons. A loan could be made in amounts up to 20% of their assets, putting the institution at risk with just one loan. The idea was to let thrifts make loans with higher returns to offset their lower returns from home mortgages. Needless to say, Congress obviously forgot about the risk of default which these loans also carried. The Garn - St. Germain Act went even farther than liberal Texas laws at that time, which stipulated that state chartered S & Ls could lend up to the appraised value of any project, or the purchase price, whichever is less.[15] The "whichever is

less" line was important because it prevented dishonesty by having the lesser of the two being the chosen price, and even if the appraised price was tampered with, the purchase price was set. When the 1982 act stripped away the purchase price and set loan amounts equal to appraisal values, Congress was asking for trouble. Generous appraisers were sought by real estate developers when asking for S & L funded loans. "That federal regulation is what killed us dead," states Linton Bowman III, the former commissioner of the Texas Savings And Loan Department.

Realizing the opportunities, Texas developers bought or created S & Ls for the sole purposes of funding both theirs and their friends' ventures. The famous phrase was, "Heads I win, tails the FSLIC loses". The situation was so awful that a former Denver Savings And Loan executive and former chairman of the U.S. League of Savings Institutions stated, "The need for the exclusive old time thrift has disappeared." By the mid 1980's, 80% of all S & L insolvencies involved "wrongdoing" or negligence, according to a House Government Operations Committee report.[16]

As mentioned in the last section, generous tax write-offs for real estate loans ignited Texas's market. It was this frenzy that resulted in overdevelopment and led to the market's decline.

It was apparent in 1980 that Congress must take action to help straighten out the situation. Congress reacted with

the Depository Institutions Deregulatory Monetary Act of 1980. This was a rational move. The thrifts needed to pay higher rates than Regulation Q would allow, so in the bill the interest rate ceilings were lifted.

The Garn - St. Germain Act of 1982 was an entirely different story. It allowed an S & L to fund shady developers at inflated appraisals of up to 20% of its assets, while the S & L was being kept alive by FSLIC notes. This showed a lack of thinking on the part of Congress. For this they should accept responsibility for most of the crisis. Their tax incentives to developers may have seemed like a good idea back in 1981, but now it seems the pie Congress handed the developers is back in their face.

Other problems in Congress during the crisis, are Texas Prepresentatives and Senators holding vital bills up and causing problems for the Federal Home Loan Bank Board. Representative Steve Bartlett and Senator Phil Gramm sponsored an amendment that would protect Texas's S & Ls from unwarranted closures, causing more hassles for the FHLBB. Of course, we can not forget Speaker Jim Wright, also from Texas, who unfortunately had the power to stall the Recapitalization Bill which was vital to a quick solution to the current crisis. Other members of Congress are making the crisis worse. Chairman of the House Banking Committee, Ferdinand St. Germain, said there is "no way" that Congress will commit the full faith and credit of the

federal government to promissory notes and other committments issued by the FSLIC to buyers of insolvent thrifts.[17] Statements like these have hampered FSLIC's ability to attract large companies to acquire insolvent thrifts. Ford Motor Company was interested in acquiring American Savings And Loan Associations, the nation's largest insolvent thrift. But because of concerns about FSLIC defaulting on a note, it may have played a major part in Ford Motor Company changing its mind.[18] The annoying part is that Congress would never allow FSLIC to default on a note, because of the repercussions in financial markets. It would appear as if the government was defaulting on a loan and that would be disasterous! So when congressmen say such firm statements about backing the FSLIC notes, they are causing uneasiness that will make it more difficult to abolish insolvent banks and this will bring the tab for this messy situation even higher.

VI. Should The Savings And Loan Industry Continue?

As the debate continues on resolving the current thrift crisis, one must ask: Do we really need a separate thrift industry? Are we better off without it?

There is no doubt that in the 80's we have seen the difference between a Savings And Loan and a bank disappear. Thrifts are now allowed to invest 10% of their assets in junk bonds, they can loan 100% of their net worth on loans secured by real estate, and they can also invest 40% of their assets in commercial real estate. Because many thrifts are burdened with low-rate fixed mortgages, most look toward lending in the commercial real estate area as a way to bring their returns up. This is evidenced by home mortgages taking up only 53.6% of assets and dropping, as compared to 72.6% in 1978. Also, their market share in the mortgage market has dropped to 28% from 60% a little more than a decade ago. It seems as if the neighborhood thrift is quickly developing into a full blown financial service institution.

This should be noticed by Congress, who knows that S & Ls were originally meant to provide Americans with the dream of home ownership. They are becominf direct competitors to an already crowded banking industry. With the added number of thrifts competing for money against banks for traditional banking activities, this situation will obviously hurt both

sides as cost of funds soar with interest rates from the competition for funds. It is clear that this competition may cause serious repercussions on the economy as some banks and thrifts will be closing quickly, because those that are locked into fixed-rate assets will not have a chance to survive in this new environment that is just emerging.

There is a positive side to the S & L industry. Two-thirds of all thrifts turn a profit, and a rather respectible one at that - $6.6 billion in 1987.[19] But the fact remains that one-third of the industry lost over $13 billion and their eventual bailout may cost over $100 billion before it is over. There must be some serious repercussions on an industry with this many problems.

It should be pointed out that this was an unsound business from the start, because of its policy of investing liquid deposits in illiquid mortgages. Now the $1.1 trillion industry's role in housing finance is eroding as mortgage bankers and commercial banks become increasingly active players. As Rodgin H. Cohen, a partner at Sullivan & Cromwell, states it, "Banks are so heavily into mortgages anyway that I really have to question whether there is a need for a separate industry."

With all the public debate going on about how to resolve the crisis, the U.S. League of Savings Institutions, who years ago were begging for deregulation and entrance into other markets, are in fear of losing their industry.

They are proposing a return to emphasizing the Savings And Loan Industry's traditional role in making home mortgages.

As of early 1989 it is appearing that the thrift industry is on a collision course with the banking industry. Thrifts are offering more services than ever before. There are already over 13,000 banking institutions in America and I am not sure if the industry can handle 3,000 thrifts competing head-on without their being several hundred losers in the form of insolvency. We may be witnessing the birth of the next crisis, if thrifts continue to have many of the same powers that banks do.

VII. What Are The FHLBB-FSLIC Doing About The Crisis?

The Federal Home Loan Bank Board has currently found itself in a difficult spot. With hundreds of insolvencies and a third of the industry losing money, the FHLBB is in the middle of a disaster. Not knowing if the Bush Administration will merge the thrifts into the FDIC and therefore scrap the Bank Board, it has led to some concern in the thrift industry.

The FHLBB, which historically has imposed less stringent capital requirements and regulation than their banking counterparts, has done little to curb the growth of many fraudulant owners. It is clear that FSLIC has done a terrible job of watching over thethrifts, when they only are budgeted a payroll for 19 Texas regulators, in an environment that needs almost 5 times as many, it can hardly be the fault of the FSLIC.

The FHLBB does deserve some blame for their 1982 action. This action removed the 5% limit on brokered deposits - fast, high-rate money rounded up by investment brokers and the other firms, that gave many thrifts liquidity but at the expense of a higher cost of funds. With expenses increasing partly due to the increased use of brokered deposits, Congress then passed the Garn - St. Germain Act which led to rapid growth in the industry. It was in the mid-80's that the FHLBB chairman, Edwin Gray,

sensing a deregulatory disaster in the making, began to reform the industry. Gray single-handedly reregulated the industry by hiring hundreds of new examiners and supervisory agents at the regional bank level, established growth limitations, doubled capital requirements, limited brokered investments and direct investments, and cracked down hard on inflated appraisals.[20]

A major move made by the FHLBB was forcing reappraisals based on current market value rather than on historical value. When this was done it sparked a vicious wave of foreclosures. Much of the developers' collateral was devalued by as much as 30%. This forced developers to declare their projects insolvent, which in turn forced the S & Ls to declare the loans nonperforming, which in turn forced the FHLBB to declare the S & Ls insolvent. Even though this was a corrective action that must have been taken, it devastated many owners caught unexpectedly by this monumental move.

To raise additional money for FSLIC, the FHLBB came up with a special assessment, that increased the insurance premium on deposits by 2 1/2 times. This plan, started in 1985, was to attract enough revenue so that FSLIC would not have to rely on taxpayers for a bail out. The $1.2 billion it raises each year helps but does not even come close to alleviating the taxpayer from using his money to solve the crisis. In fact, it is under severe criticism for stripping

profits from thrifts when they need them to build up their capital. Thrifts with a loss are experiencing even greater losses and are becoming even more insolvent by these assessments. "We're watching a hemorrhaging of healthy thrifts to save the sick," states House Banking Committee member Stan Parris (R - Va.).

It was soon realized that the problem was that neither the industry nor the government could afford to pay for the results of FHLBB's hard line from such rules as the reassessment of collateral that spurred the mass of insolvencies. "Once we identified the problems, we realized over half of the 280 S & Ls in Texas were insolvent," recalls Selby. "But we couldn't shut them down because FSLIC didn't have enough money." As the insolvencies were mounting, many thrifts were solvent due to special certificates issued by FSLIC. These special certificates were counted as capital by regulators, which created a false illusion of solvency for these banks.

As FSLIC watched their fund being drained by these insolvencies, they turned to the government for a quick bail-out solution, to which they would use the funds to close the insolvent thrifts. Because of the thrift owners' clout, especially in Texas, the bill was passed a year later and with less than adequate monies available.

As estimates of the final cleaning bill grew higher every day, it was time for action. In February of 1988,

FHLBB Chairman M. Danny Wall announced a new plan to take care of the hundreds of insolvencies. This plan, called the Southwest Plan, intends to dispose of the problem thrifts by making them look attractive to outside investors. These investors would then be encouraged to take clusters of problem banks off of FSLIC's hands. FSLIC makes these sick thrifts attractive with FSLIC guaranteed notes or cash so that the negative net worth is wiped out. Also, FSLIC promises to cover the cost of carrying nonperforming assets until they recover in value or can be sold. Even though this sounds like a free ride for an investor, it is not. FSLIC will get an equity stake or a profit-based kicker to the extent that FSLIC is invested in the required thrift.

The Southwest Plan came about because FSLIC can not afford massive liquidations, and since merging is about 85-90% of the cost of liquidating, FSLIC can take care of more thrifts. The thinking behind the Southwest Plan's idea for clustering groups of thrifts together is that the thrifts will save money by combining and streamlining operations and thus they would stand a better chance of survival.

The potential problems with the plan can be devastating. The mergings of the FHLBB are being propped up almost exclusively by FSLIC notes. These notes are receiving criticism in Congress because Congress feels that FSLIC is committing too much money to these mergers.

Several Congressmen have even publicly said that they would not support funds to cover the notes. This controversy has unfortunately made it more difficult for FSLIC to get rid of thrifts. The Ford Motor Company backed out of a recent interest in the Financial Corporation of America, which is the holding company for the nation's second largest savings and loan association. It is easily the largest problem bank in the nation, probably because of the uncertain guarantee of FSLIC notes, brought on by certain members of Congress.

Also, these billions of dollars in notes that are meant to make insolvent thrifts look attractive are adding little cash to the acquired institutions' capital base. This brings the fear that someday these clusters of sick thrifts may eventually fall helplessly into insolvency again. This thinking reminds the FHLBB that without adequate regulation and making sure that these new thrifts are being put into safe hands, we may see another financial disaster in later years.

If everything works the way Mr. Wall would like it to, the Southwest Plan could save the thrift industry in Texas more than $1.2 billion a year. The plan would save thrifts $500 million in operating costs by merging some 100 thrifts and reducing branches by 400. In April, 1988, Wall stated, "In three years I believe we will have dealt with a major portion of the insolvent and troubled institutions. We will have contracted to solve most of the remaining problems, and

the industry will be on its way to complete recovery five or ten years from now."

Mr. Wall and the FHLBB think the Southwest Plan will reduce competition among shaky institutions for brokered deposits. This reduced competition will lower the interest rates needed to attract deposits.

By keeping these insolvent thrifts open, instead of liquidating them, this hurts the small solvent S & Ls whose conservative lending practices kept them afloat while others were sinking. Now they are threatened by these insolvent superthrifts being subsidized by taxpayers' money.

Many people believe that the Bank Board is buying time, and hoping for the real estate market to turn around. This would attract more capital from outside investors and would cut government funded bail-out costs. Also, the Board does not want to dump prime real estate at fire-sale prices because it would further undermine the market, so it is simply being stored until prices are more favorable to outside investors.

While the FSLIC tries to figure out its next step to resolve the S & L industry's crisis, Congress should be supportive of its efforts and help FSLIC out of its $16 billion deficit, which is increasing at a rate of $1 billion a month.

Now it is March, 1989. The Southwest Plan is discontinued with just as many insolvent thrifts still operating, and with the industry being light years away from recovery.

VIII. Policy Recommendations.

Over the next several pages I will point out several alternatives that may be imposed on the thrift industry in an attempt to resolve the crisis.

The first alternative, which is currently in effect, is the use of a special assessment on thrifts in the form of increased insurance premiums amounting to $1.2 billion a year. It began in 1985 and is slated to continue for an additional 30 years. This has come under heavy fire from the thrift industry, because of the profit draining that occurs from the assessment. This lost profit, argues the thrift industry, would have been capital, and the way for the industry to become more solvent is through increases in capital. The tax is also being blamed for running sick thrifts into the ground by using up whatever capital they had acquired.

My opinion on this special assessment has to do with the fact that the industry is to be blamed before the taxpayers. The taxpayers are obviously going to have to use their hard earned money to bail out the crooked dealings of many thrift owners. The least that the industry can do is admit some fault, since it was their lobbying groups that helped pass the deregulation legislation. They should attempt to pay a meager sum of $1.2 billion, as compared to the $100 billion or so coming from the workers of America.

The FSLIC will not even be able to collect all $1.2 billion because some of the tax paying S & Ls will be merged or liquidated and will not have to pay or can not pay their portion of the tax. So it will end up being the stronger thrifts paying most of the premiums, which they can afford.

The next idea has many thrifts converting from FSLIC to FDIC. The FSLIC will remain for the sole purpose of taking care of the sick thrifts left under its regulatory jurisdiction. Once this is completed, FSLIC will be dissolved. The strong thrifts may be given a certain amount of time to meet FDIC requirements, during which these thrifts will no doubt be constantly under the surveillance of the very tough FDIC regulators. As compared to the FSLIC, the FDIC has more experienced personnel, and have a better track record of keeping businesses on firm footings.

This idea may come under intense criticizm by present bank owners whose money has gone to building up the $15 billion surplus in the FDIC insurance fund. A loss of confidence in the thrift industry may topple these stronger thrifts which would then be funded by money, which they did not contribute to. This would send banks screaming to their nearest legislator about how unfair this situation is.

The bottom line is whether or not it is unfair to the taxpayer to have to give up $100 billion in hard-earned money. Everyone will have to contribute, even the banks, if necessary.

The next idea may be very controversial, if ever proposed, but it is actually a viable alternative. This idea involves extending of insurance to all deposits, not just up to $100,000.

In this world of rate chasing, thrifts would see billions of dollars come into their industry by foreigners looking for a safe investment but a higher return than T-Bills. This would lead to a fair amount of growth, but with regulators keeping an eye on where it is going, it should be a safe growth.

Another reason for this thought is that the additional coverage should alleviate any fears of possibly losing any money in the system. This reduction of risk will allow thrifts to offer a lower rate, comparable to Treasury Bills, because of the default risk now being eliminated. These additional funds should lessen the thrift's reliance on brokered deposits, and thus bring their cost of funds down.

Probably the main reason for making this choice is because on all large thrift mergers or liquidation the government drops the ceiling and insures all deposits. So since they insure most deposits anyway, they might as well publicly announce it so that interest rates will be less for these sick thrifts. They can then start a new healthy growth with these additional funds.

The next issue has to do with a risk-adjusted insurance premium. Presently thrifts pay 20.8 cents for every $100 of

deposits to the FSLIC, regardless of the riskiness of their loan portfolio. Thus, there is no reward for a thrift having a safe portfolio, as they get charged the same rate as one that has junk bond holdings and large amounts of commercial real estate loans.

Heavy criticizm is drawn because of the difficulty of being able to measure or to define "risk". And how do you deal with the fact that what is safe today may be risky tomorrow?

A simplistic way to assess risk may be measured by percentages of each category in the thrift's portfolio. To start with, lets consider junk bond investments. These may be the most speculative investments for thrifts, which are allowed a maximum of 10% in their portfolio. I would propose that these investments be charged a 50 cent insurance premium for every $100 involved. The major risk of this category is the chance of default which would result in usually a 70% loss of the original investment.

Next, lets examine commercial real estate lending. Though it is risky, it usually has sound collateral to back up the loan in case of default. Thrifts are allowed to invest up to 40% in this area. An adequate insurance premium would be about 30 cents for every $100. This is significantly less than junk bond investments, because of the higher recovery on collateral. The premium will also be significantly higher than home mortgages, to discourage the

lending in the commercial area in favor of lending to home owners. The liquidity difference between the two is also a major factor. The quick selling of commercial real estate usually results in a reduction in price, while home mortgages may be sold in the secondary market to willing investors at no loss.

Last, we need to consider a risk-related premium for home mortgages. For this category I would prefer a 15 cent per $100 invested in home mortgages. With these mortgages there is a very active secondary market willing to take them off of thrifts' hands quickly and without a loss. Also, this substantially lower amount, when compared to other alternatives, will reward those conservative thrifts who have shyed away from risk and remained with home mortgages. It hopefully will result in a shift by thrifts back to helping Americans finance their homes.

Though I have dealt with measuring risk, I should now explain what information can be used to determine risk. I realize that in the ever changing world of the thrift industry, present financial information may be different a few months down the road. This risk adjusted system would have to use past information, but on a quarterly basis, so it is kept relatively fresh. Each S & L would be required to present FSLIC with amounts in each category, to which the FSLIC would bill each thrift for the appropriate amount. With this set up I feel that the financial statement will

stay relatively the same in three months time, and that this system will show proportionality in premiums by risk.

This system also builds in the special assessment which thrifts are subject to. It should work out to an average of about 20-21 cents per $100. It also has a built-in incentive. If S & Ls want to pay below this average amount, they just shift more into their home mortgage portfolio. I must stress that risk-adjusted premiums can and should be used!

The next recommendation has to do with preventing insolvent thrifts from keeping their doors open. Actually, this plan would shut down thrifts before they even become insolvent. The way it works is that when thrifts get to the point where capital is only one half of one per cent of assets, thrift regulators would move in and liquidate immediately. I would recommend liquidation because the S & Lwill never have to be worried about it again. Merging it with another institution would only make its capital asset ratio plummet and may endanger its existence immediately.

The reasons why I came up with half of one percent is that it should be low enough to tell how a bank is really doing. If a bank's ratio drops to two percent or even one percent, that may just be a temporary fluctuation and there is still enough capital left for a thrift to handle a few major loan losses. But when it reaches half of one percent, it is on the verge of being insolvent, and it might even be

if a major loan suddenly goes bad. This amount also allows for a loss in asset value due to possible fire-sale losses that may occur when regulators liquidate the institution, thus minimizing the cost of a taxpayer bailout if the remaining capital can not cover the fire-sale losses.

I think this is aan important recommendation that should prevent any kind of crisis from ever happening again. It was the ability of the incredibly insolvent institutions to stay open for months or even years later, doing the same kind of business that made them insolvent in the first place.

Something else that must be stressed in this recommendation is that the capital be computed without subordinated debt, FSLIC notes, or anything else that would give capital an unrealistic boost. The fact that these instruments were even allowed to be included in capital is just one of the ways that shows the irresponsibility of the regulators. We must be up front with capital and not try to hide it with increases in debt.

The last recommendation proposes the curbing of the harmful legislation that contributed to our own crisis. Much of this legislation was brought on by the thrift industry's powerful lobbying groups.

The legislators and lobbyists were responsible for the two main deregulation bills for the industry. Of these two bills it was the Garn - St. Germain Act of 1982 that turned

the industry upside down by allowing thrifts to diversify into much riskier activities.

What Congress needs to act on now is to scale back the industry that they set loose only a few years ago. Commercial real estate lending, which is allowed to be 40% of assets, exposes the thrift to fluctuations in the economy that might ultimately lead to its failure. This is the main reason why the S & Ls in the Southwest region are in sad shape.

I would propose a reduction in the maximum percentage that commercial lending may occupy in the loan portfolio. By lowering the percentage to 20, it should still allow for a good contribution to profit, while exposing the bank to considerably less risk. This 40 percent maximumhas given S & Ls the choice to diversify out of the stable fixed-rate home mortgages and into the volatile commercial market. The high returns are the main attractiveness of these commercial real estate loans. Unfortunately, many thrifts fail to consider the risk involved and instead are lured by the high returns.

The Garn - St. Germain Act also allowed a 10% investment into the junk bond market. This was a poor attempt by legislators to try to increase profits for the industry. Investment in speculative bonds is dangerous because if a company goes bankrupt, the thrift may only

receive pennies on the dollar, resulting in a potentially damaging loss.

To sum up the section, I recommend the continued use of the special assessment to help the taxpayers cover some of their losses. I also would propose a plan to move all thrifts into the more experienced and stricter FDIC. Healthy thrifts would make a quick jump into the FDIC, while weaker ones would stay until they meet FDIC standards or are liquidated by FSLIC.

To help draw in new deposits, I would propose a change in the insurance coverage to allow all size deposits to be insured. This should also decrease the cost of funds by lowering interest that would be paid to large deposits because of all risk of loss being wiped out by the full insurance coverage.

There must also be a change in the way the government charges thrifts for insurance coverage. By not taking account of the risk, it encourages thrifts to have a more risky portfolio without a penalty for the increased exposure. These riskiest thrifts end up having the same insurance premium as the safest thrifts. Our system needs to be able to reward the safe thrifts and encourage riskier thrifts to play it safe.

A scaling back of the industry is an important step to help prevent another crisis from happening. It is also

crucial in order to help thrifts to get back on their feet again. It was the deregulation of the industry in the early eighties that allowed banks to diversify out of home mortgages and eventually led to their downfall. What is now needed is reform. Congress must now take away the powers that they gave to the thrifts. This should be the first step taken in order to lead to a recovery for the industry.

Probably the main reason we are in this crisis is due to the FSLIC allowing insolvent thrifts to remain open, some propped up by FSLIC notes to make them appear solvent, and allowing these thrifts to make the same bad decisions that made them insolvent. By allowing these S & Ls to stay open and grow, it only added to the final tab, which was paid by the taxpayer. It was not necessarily the fault of FSLIC, because they did not have the funds in thier account to close the thrifts. It was FSLIC who begged Congress for more funds to close these thrifts, but they received too little too late. So my recommendation is for Congress to give FSLIC the funds it needs quickly to take care of the insolvencies and to close all other S & Ls when they reach one half of one percent of capital to assets. This will help prevent another crisis from occurring.

So as you can notice from the last few paragraphs, the answer to the crisis is in the hands of Congress, if they can just react fast enough to take care of this messy situation.

IX Summary.

The Savings And Loan Industry is fighting for its life, as close to one-third of the industry seems to be having serious financial difficulty. There are approximately 500 insolvent institutions still allowed to operate and to thus fall even deeper into debt. This continuation of business has driven cleanup estimates at over $100 billion, and unless money is allocated to take care of these insolvencies, it will only make the final bill that much more unbearable.

Most of the problem began in the early eighties when high interest rates caused the S & L's expenses to be greater than their income. This outflow of capital spurred thrifts to pressure their legislators to help the industry. Congress reacted to the pleas with the Deregulation Act of 1982. This Act permitted thrifts to heavily invest in the commercial real estate market and even the junk bond market, while stripping the interest rate limits that stated a maximum that thrifts could pay. It was a combination of deregulation and falling oil prices that sent the Texas thrifts on a course headed for destruction. Real estate developers borrowed and built on the assumption of oil prices reaching $100 a barrel. Borrowing soon became easy as money poured in, because of the higher rates thrifts could now offer, in anticipation of lending it out at even

higher rates to developers. Unfortunately, oil prices fell and many oil companies went out of business, depressing the Texas economy. A glut of office towers, shopping centers and housing were apparent. Developers were not generating enough income to pay off their mortgage and were soon foreclosed upon. This left the thrift with a loss, due to low real estate prices, if they sold the building. The alternative would be to tie up their assets by holding on to the illiquid building. After a number of losses, the S & L soon found itself insolvent and needing assistance. When FSLIC ran out of money in 1986, while the problem was small, it quickly went to Congress for money to take care of the remaining insolvencies. When the industry realized the money would be used to shut down some of its members, it pressured some of its political allies to stop any funding. Speaker of the House, Jim Wright, happened to be an ally to the thrift industry, primarily due to the funds which the industry raised in past campaigns for him. Speaker Wright used his influence to pass only two-thirds of what was asked for and also delayed the bill by over a year. This resistence and delay may have added a few billion dollars to the taxpayers' cost.

It is apparent that Congress is primarily to blame for this crisis by not allowing sufficient funds to take care of this messy situation while the problem was relatively small. Also, the deregulation acts caused the speculative

investments to go into unfamiliar territories that have brought down money in the industry. One of my primary recommendations discussed implementing a risk-adjusted insurance premium designed to reward the safe thrift and penalize the risky thrift. By calculating a fixed premium per $100 for each area of investment varying by the risk involved, you then multiply this premium by the number of $100 units you have in this area. By recalculating this amount quarterly, it should keep the thrifts risk up-to-date.

My other main recommendation dealt with the quick closing of the S & L once it reached an arbitrary point in capital. There should be enough capital left to cover the fire-sale losses that will occur from liquidation, so the tax payer will no longer have to worry about putting any more money into the industry.

Once again, quick action that is adequate for the situation is required. Congress must make the first step by allocating clean-up funds. At the same time, it must reregulate the industry by forcing it back into its traditional role in home mortgages.

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[3]Business Week, November 21, 1988, p. 96+.

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[5]Business Week, op. cit., p. 96+.

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[14]J.P. Newport, Fortune, April 11, 1988, p. 81.

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APPENDIX A

ALL INSURED THRIFTS
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 86,299,985 $	89,631,238 $	91,971,122 $	77,166,447
Interest Expense	73,615,369	72,795,187	72,568,770	63,392,629
Net Interest Inc. (Exp.)	12,684,616	16,836,051	19,402,352	13,773,818
Other Operating Income:				
Mortgage Loan Fees	3,016,296	3,491,983	3,146,358	1,177,972
Loan Servicing Fees	615,114	829,672	1,017,429	847,188
Other Loan Fees & Charges	805,695	1,006,152	980,095	681,167
Ser.Chgs. & Fees - Trans.Accts.	533,163	685,639	823,981	728,982
Service Corps./Subsidiaries	1,461,405	1,349,868	348,094	287,466
Other	1,666,720	2,238,830	1,481,694	1,429,881
Total Oth. Operating Income	8,098,393	9,602,144	7,797,651	5,152,656
Operating Expense:				
Officers & Employees Comp.	6,393,694	7,689,203	8,775,706	6,948,140
Legal Expense	189,612	275,460	373,497	336,340
Office Occ. & Equip. Expense	3,122,362	3,698,878	4,197,682	3,464,651
Marketing Expense	718,953	785,449	893,047	673,483
Professional Services	316,057	427,270	505,684	421,032
Amortization of Goodwill	818,638	999,932	1,101,486	834,707
Other	4,829,988	5,727,304	6,213,195	4,691,201
Total Operating Expense	16,389,304	19,603,496	22,060,297	17,369,554
NET OPER. INCOME (DEFICIT)	4,393,705	6,834,699	5,139,706	1,556,920
Non-Operating Income:				
Profit on Sale of REO & Other	441,587	450,560	514,652	375,332
Profit on Sale of Investments	1,761,509	2,438,398	1,241,958	1,043,584
Profit on Sale of Loans	2,732,502	3,649,394	2,403,759	1,104,229
Amortized Deferred Gains	75,208	52,563	44,564	10,508
Other	799,742	847,113	1,128,201	770,145
Total Non-Operating Income	5,810,548	7,438,028	5,333,134	3,303,798
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	5,595,873	6,304,989
Loss on Sale of REO & Other	642,212	1,304,191	568,632	378,874
Loss on Sale of Investments	382,113	547,330	606,432	342,941
Loss on Sale of Loans	1,299,017	3,168,379	769,800	374,907
Amortized Deferred Losses	289,177	346,487	367,624	230,502
Other	460,908	1,070,494	1,359,885	356,708
Total Non-Operating Expense	3,073,427	6,436,881	9,268,246	7,988,921
INCOME (LOSS) BEF. TAXES & ADJ.	7,130,826	7,835,846	1,204,594	(3,128,203)
Income Taxes (Credits)	1,979,071	3,105,509	2,686,522	1,655,963
NET INCOME (LOSS) BEFORE ADJ.	5,150,731	4,730,151	(1,412,853)	(4,743,755)
Prior Period Adjustments	(471,756)	(745,439)	(188,487)	(338,030)
ADJUSTED NET INCOME (LOSS)	$ 4,678,987 $	3,984,708 $	(1,601,343) $	(5,081,785)

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 18,839,534	$ 19,561,543	$ 20,529,217	$ 17,015,286
Interest Expense	14,952,285	14,465,200	14,377,144	12,225,839
Net Interest Inc. (Exp.)	3,887,249	5,096,343	6,152,073	4,789,447
Other Operating Income:				
Mortgage Loan Fees	596,105	820,165	749,603	262,398
Loan Servicing Fees	98,395	124,624	159,816	126,650
Other Loan Fees & Charges	171,724	214,406	207,353	129,586
Ser.Chgs. & Fees - Trans.Accts.	93,697	121,713	153,126	136,518
Service Corps./Subsidiaries	160,460	213,679	127,108	130,109
Other	326,199	393,143	349,431	313,976
Total Oth. Operating Income	1,446,580	1,887,730	1,746,437	1,099,237
Operating Expense:				
Officers & Employees Comp.	1,420,740	1,730,276	1,969,415	1,578,097
Legal Expense	30,163	40,766	48,349	38,849
Office Occ. & Equip. Expense	637,233	758,598	880,531	720,504
Marketing Expense	150,078	167,973	200,813	156,939
Professional Services	55,078	73,907	90,916	81,943
Amortization of Goodwill	98,690	101,118	144,874	110,596
Other	977,857	1,138,478	1,259,347	925,176
Total Operating Expense	3,369,839	4,011,116	4,594,245	3,612,104
NET OPER. INCOME (DEFICIT)	1,963,990	2,972,957	3,304,265	2,276,580
Non-Operating Income:				
Profit on Sale of REO & Other	48,601	45,957	59,378	37,675
Profit on Sale of Investments	226,938	334,342	174,570	152,469
Profit on Sale of Loans	291,301	443,892	237,376	127,146
Amortized Deferred Gains	4,692	5,048	5,032	889
Other	113,835	109,006	218,963	93,709
Total Non-Operating Income	685,367	938,245	695,319	411,888
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	395,059	290,198
Loss on Sale of REO & Other	83,581	133,245	72,528	55,665
Loss on Sale of Investments	125,755	43,921	78,539	47,266
Loss on Sale of Loans	191,291	305,152	121,034	60,829
Amortized Deferred Losses	29,765	41,942	35,514	16,550
Other	72,717	131,547	241,795	48,228
Total Non-Operating Expense	503,109	655,807	944,469	518,736
INCOME (LOSS) BEF. TAXES & ADJ.	2,146,248	3,255,395	3,055,115	2,169,732
Income Taxes (Credits)	657,237	1,107,241	1,180,214	747,508
NET INCOME (LOSS) BEFORE ADJ.	1,488,619	2,148,129	1,883,341	1,426,431
Prior Period Adjustments	(78,728)	(40,403)	(3,042)	(63,356)
ADJUSTED NET INCOME (LOSS)	$ 1,409,890	$ 2,107,716	$ 1,880,305	$ 1,363,072

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 42,959,331 $	45,060,738 $	47,223,748 $	40,473,531
Interest Expense	36,674,887	36,279,069	36,700,559	32,492,942
Net Interest Inc. (Exp.)	6,284,444	8,781,669	10,523,189	7,980,589
Other Operating Income:				
Mortgage Loan Fees	1,536,221	1,828,970	1,737,673	635,394
Loan Servicing Fees	297,295	431,863	582,631	465,448
Other Loan Fees & Charges	415,072	531,296	539,024	395,455
Ser.Chgs. & Fees - Trans.Accts.	256,457	327,575	401,946	359,802
Service Corps./Subsidiaries	744,556	995,976	682,177	451,700
Other	809,997	1,399,878	834,719	741,418
Total Oth. Operating Income	4,059,598	5,515,558	4,778,170	3,049,217
Operating Expense:				
Officers & Employees Comp.	3,092,897	3,741,399	4,417,326	3,465,305
Legal Expense	84,541	112,071	147,683	130,264
Office Occ. & Equip. Expense	1,499,203	1,793,794	2,074,006	1,731,026
Marketing Expense	353,385	394,666	449,833	344,539
Professional Services	154,372	192,291	244,623	184,220
Amortization of Goodwill	272,503	308,795	352,135	286,467
Other	2,330,328	2,833,584	3,162,025	2,366,474
Total Operating Expense	7,787,229	9,376,600	10,847,631	8,508,295
NET OPER. INCOME (DEFICIT)	2,556,813	4,920,627	4,453,728	2,521,511
Non-Operating Income:				
Profit on Sale of REO & Other	219,928	232,269	284,052	190,473
Profit on Sale of Investments	951,527	1,197,750	706,738	620,883
Profit on Sale of Loans	1,529,149	1,896,047	1,354,696	648,049
Amortized Deferred Gains	37,451	31,288	24,658	4,220
Other	201,548	223,316	475,085	358,900
Total Non-Operating Income	2,939,603	3,580,670	2,845,229	1,822,525
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	1,389,649	1,108,179
Loss on Sale of REO & Other	223,987	377,985	237,792	148,656
Loss on Sale of Investments	156,614	305,927	327,059	130,440
Loss on Sale of Loans	534,815	1,021,923	351,554	143,254
Amortized Deferred Losses	123,375	136,960	128,306	82,488
Other	201,480	478,993	544,491	145,339
Total Non-Operating Expense	1,240,271	2,321,788	2,978,851	1,758,356
INCOME (LOSS) BEF. TAXES & ADJ.	4,256,145	6,179,509	4,320,106	2,585,680
Income Taxes (Credits)	1,214,142	1,989,830	1,538,587	911,315
NET INCOME (LOSS) BEFORE ADJ.	3,041,595	4,189,615	2,825,776	1,700,695
Prior Period Adjustments	(63,101)	(79,387)	(81,038)	(168,663)
ADJUSTED NET INCOME (LOSS)	$ 2,978,504 $	4,110,225 $	2,744,731 $	1,532,035

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THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 6,060,024 $	5,880,705 $	6,116,804 $	4,138,549
Interest Expense	5,463,891	5,117,515	5,399,606	3,869,580
Net Interest Inc. (Exp.)	596,133	763,190	717,198	268,969
Other Operating Income:				
Mortgage Loan Fees	219,305	193,743	147,905	33,089
Loan Servicing Fees	10,730	15,779	17,983	31,191
Other Loan Fees & Charges	49,057	70,388	53,286	23,988
Ser.Chgs. & Fees - Trans.Accts.	22,710	27,510	31,618	26,780
Service Corps./Subsidiaries	93,229	36,956	(54,580)	(59,186)
Other	111,715	30,830	5,987	167,140
Total Oth. Operating Income	506,746	375,206	202,199	223,002
Operating Expense:				
Officers & Employees Comp.	347,148	399,736	447,107	316,425
Legal Expense	16,829	34,581	28,651	28,368
Office Occ. & Equip. Expense	154,163	180,774	194,811	143,204
Marketing Expense	32,893	32,539	40,626	27,671
Professional Services	97,412	73,314	77,033	51,954
Amortization of Goodwill	67,148	69,132	73,756	37,467
Other	286,257	287,983	276,761	184,071
Total Operating Expense	1,001,850	1,078,059	1,138,745	789,160
NET OPER. INCOME (DEFICIT)	101,029	60,337	(219,348)	(297,189)
Non-Operating Income:				
Profit on Sale of REO & Other	36,595	42,160	29,098	20,112
Profit on Sale of Investments	104,087	176,619	107,001	39,932
Profit on Sale of Loans	440,081	754,656	261,315	78,880
Amortized Deferred Gains	535	1,747	1,526	566
Other	31,649	42,904	48,332	26,407
Total Non-Operating Income	612,947	1,018,086	447,272	165,897
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	1,235,670	1,467,121
Loss on Sale of REO & Other	197,492	237,903	66,590	16,162
Loss on Sale of Investments	25,721	81,135	63,808	8,078
Loss on Sale of Loans	92,188	435,556	56,802	14,430
Amortized Deferred Losses	17,599	19,704	20,460	15,710
Other	43,142	47,378	119,107	113,490
Total Non-Operating Expense	376,142	821,676	1,562,437	1,634,991
INCOME (LOSS) BEF. TAXES & ADJ.	337,834	256,747	(1,334,513)	(1,766,283)
Income Taxes (Credits)	90,346	85,543	(72,376)	(14,837)
NET INCOME (LOSS) BEFORE ADJ.	247,467	171,205	(1,254,971)	(1,746,722)
Prior Period Adjustments	(17,327)	(3,597)	(5,593)	(9,924)
ADJUSTED NET INCOME (LOSS)	$ 230,142 $	167,608 $	(1,260,563) $	(1,756,648)

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THRIFTS W/TANG. CAP. <= 0, NET
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 17,906,658	$ 18,356,498	$ 17,586,778	$ 14,191,010
Interest Expense	15,983,535	15,898,213	15,114,634	12,929,779
Net Interest Inc. (Exp.)	1,923,123	2,458,285	2,472,144	1,261,231
Other Operating Income:				
Mortgage Loan Fees	629,115	623,150	511,822	228,513
Loan Servicing Fees	194,272	230,683	219,146	211,334
Other Loan Fees & Charges	149,480	183,824	171,348	118,752
Ser.Chgs. & Fees - Trans.Accts.	133,709	174,806	197,227	170,864
Service Corps./Subsidiaries	256,026	160,283	(207,232)	(138,032)
Other	407,698	389,905	286,255	257,128
Total Oth. Operating Income	1,770,300	1,762,651	1,178,566	848,559
Operating Expense:				
Officers & Employees Comp.	1,408,711	1,663,945	1,777,584	1,408,241
Legal Expense	54,605	89,433	116,373	113,341
Office Occ. & Equip. Expense	746,145	860,076	925,788	753,201
Marketing Expense	163,812	170,104	184,676	128,226
Professional Services	75,736	116,497	118,664	108,746
Amortization of Goodwill	360,599	502,608	519,160	369,845
Other	1,145,002	1,296,833	1,328,301	1,014,053
Total Operating Expense	3,954,610	4,699,496	4,970,546	3,895,653
NET OPER. INCOME (DEFICIT)	(261,187)	(478,560)	(1,319,836)	(1,785,863)
Non-Operating Income:				
Profit on Sale of REO & Other	103,875	105,459	123,653	93,250
Profit on Sale of Investments	357,906	576,157	206,744	212,132
Profit on Sale of Loans	597,483	839,283	605,137	281,575
Amortized Deferred Gains	30,714	11,623	12,854	4,565
Other	407,410	371,589	226,503	169,479
Total Non-Operating Income	1,497,388	1,904,111	1,174,891	761,001
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	2,362,225	2,945,237
Loss on Sale of REO & Other	195,733	527,314	152,357	108,801
Loss on Sale of Investments	65,373	78,263	123,644	128,084
Loss on Sale of Loans	444,891	1,153,403	180,462	128,998
Amortized Deferred Losses	104,372	129,343	166,430	96,612
Other	138,050	314,427	329,445	98,686
Total Non-Operating Expense	948,419	2,202,750	3,314,563	3,506,418
INCOME (LOSS) BEF. TAXES & ADJ.	287,782	(777,199)	(3,459,508)	(4,531,280)
Income Taxes (Credits)	27,805	(57,600)	30,954	14,850
NET INCOME (LOSS) BEFORE ADJ.	259,798	(719,730)	(3,482,170)	(4,541,924)
Prior Period Adjustments	(79,581)	(286,185)	(50,901)	(102,323)
ADJUSTED NET INCOME (LOSS)	$ 180,219	$ (1,005,909)	$ (3,533,073)	$ (4,644,245)

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